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C O N F I D E N T I A L SECTION 01 OF 04 BAKU 001066

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SUBJECT: EEB A/S SULLIVAN'S ENERGY DISCUSSIONS

Classified By: Ambassador Anne E. Derse for reasons 1.4 (b) and (d).

¶1. (C) SUMMARY: During his August 15-16 visit to Baku, GOAJ officials echoed President Aliyev's frustration with Turkey for reaching a deal with Greece and Italy on "Caspian gas;" Finance Minister Sharifov also complained that Turkish Energy Company BOTAS was not empowered to negotiate the many outstanding legal and technical issues, and called for talks to be escalated from companies to governments. GOAJ officials welcomed USG outreach to Turkmenistan and affirmed Azerbaijani interest in working with Turkmenistan to develop Trans-Caspian corridors. Foreign Minister Mammadyarov urged the USG to assign a higher profile to its energy diplomacy and welcomed the USTDA Grant Agreement for a trans-Caspian feasibility study as the type of initiative currently needed. A/S Sullivan applauded a regional initiative, proposed by Kazakhstan, to conclude a trilateral agreement with Turkmenistan and Azerbaijan on cross-Caspian energy export options, and agreed to work with Azerbaijan to encourage the EU to enhance its presence in the Caspian region. BP officials said that Shah Deniz full field development and new ACG development would be enough "to fill Nabucco for years" but cautioned that the lack of a commercial contract for ACG continues to make Europe skittish. End Summary.

¶2. (C) Visiting EEB A/S Sullivan met GOAJ energy interlocutors on August 15-16 in the lead-up to the signing ceremony for a TDA grant for a feasibility study on trans-Caspian oil and natural gas pipelines. A/S Sullivan briefed GOAJ interlocutors on his recent meetings with Turkmen government officials, and discussed the current state of oil and natural gas production in Azerbaijan's offshore sector, as well as future development of Azerbaijani and Caspian Sea energy resources. A/S Sullivan encouraged Azerbaijan President and Foreign Minister to continue dialogue with Turkmenistan on trans-Caspian gas and Caspian delimitation issues, and urged Azerbaijan's leadership to press ahead with Turkey on a natural gas transit agreement. A/S Sullivan met with President Aliyev, State Oil Company of Azerbaijan (SOCAR) President Abdullayev, Minister of Finance Sharifov, Foreign Minister Mammadyarov, and representatives from BP and the American Chamber of Commerce. Other USG officials at the meetings included Ambassador Derse, EEB officer Rob Garverick, USTDA General Counsel James Wilderotter, DOE analyst Tyler Tiller, and Pol/Econ officers (notetaker). A/S Sullivan's broader economic discussions are covered in septels.

SOCAR

13. (C) A/S Sullivan gave SOCAR President Abdullayev a readout of his recent talks with Turkmen President Berdimuhamedov on trans-Caspian energy issues. Commenting that there was a role for the GOAJ to play in educating the Turkmen leadership on developing their natural resources, Sullivan asked Abdullayev what he viewed as the key issues in the energy relationship. Abdullayev said that "in order to teach someone something, you must have a relationship with that person" and commented that there were several "investment issues" with Ashgabat that needed to be resolved for the relationship to move forward. Abdullayev emphasized that the GOAJ continues to be committed to being a transit state for the transport of Caspian energy resources, including Turkmen gas, to Europe and that the Turkmen could learn from the GOAJ's experience; however, the GOTX continues to refuse Azerbaijani offers of technical assistance. Abdullayev requested greater USG involvement in convincing the GOTX that engagement with the GOAJ can benefit development of their natural resources. A/S Sullivan noted that he had told Turkmen officials that Azerbaijan's energy development experience could be a good model for Turkmenistan.

14. (C) Abdullayev also gave a readout on SOCAR's transit negotiations with Turkey. Abdullayev said that the GOAJ was very surprised by the recent TGI MOU and expressed disappointment that these countries concluded an agreement about "Azerbaijani gas" without Azerbaijan's involvement. (President Aliyev expressed similar views to A/S Sullivan and earlier to EUR DAS Matt Bryza) see septels.) Abdullayev said that Turkish interlocutors made clear, as is evident in the MOU, that the Turkish Government's goal was to become an energy hub rather than a transit state. Abdullayev stated

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that the two sides had agreed upon a 15 percent netback for Turkey, but there had been no progress in other areas because of the GOT position. Abdullayev said that the GOT had taken the position during the last round of negotiations that it would not allow the GOAJ to pursue downstream supply contracts with Greece and Italy until the GOAJ agreed to Turkey's condition that June 1 serve as the trigger date for starting the contract on Shah Deniz Phase I gas. (Comment: This date is significant because the Turks are guaranteed gas at a reduced rate for one year from the trigger date.)

15. (C) Abdullayev said that the GOAJ had responded to this threat by telling the GOT that it would not begin negotiations with GOT on Shah Deniz Phase II gas until the GOT had conceded the point on downstream supply contracts. Abdullayev said that they would continue to engage Turkey in transit negotiations, but that time was getting short with the original terms of the Shah Deniz supply contract coming close to expiration. In spite of these problems, Abdullayev emphasized that the GOAJ was committed to playing a positive role as a transit state in the transport of Caspian Sea energy resources to Europe, and to engaging Turkmenistan on getting a transport agreement in place. Abdullayev (and other GOAJ interlocutors) urged that the USG continue to encourage the Turks to resolve this issue, and move ahead on the transit talks.

BP's Views

16. (C) During an August 15 dinner hosted by the Ambassador, senior BP officials provided an update on their own activities in the Caspian, their thoughts on Europe's view toward Azerbaijani supply, the prognosis for gas supply to Georgia this winter, and ongoing Azerbaijan/Turkmenistan engagement. Attending from BP were BP-Azerbaijan President Bill Schrader, Gas Marketing Manager Richard Ruddiman, Director of Communications and External Affairs Clare Bebbington, and Vice President of Exploration and New Developments Paul Clyne.

¶7. (C) Schrader said that the GOAJ's criticism of BP for the lower-than-expected production figures for this year had prompted BP to refrain from further production forecasts. Schrader commented that BP had submitted a strong proposal for development of ACG Deep Gas to the GOAJ two weeks prior, including a provision doubling SOCAR's participation in the project. Schrader said that, as of August 15, BP had not heard from the GOAJ on the proposal, but interpreted the lack of the usual GOAJ bluster about the inadequacy of the proposal as a good sign. In response to a query from Sullivan on further Shah Deniz production, BP's Clyne said - noting the information is not yet public-that BP has discovered an additional find below the current area covered by the original Shah Deniz PSA, measuring 20,000 psi and more than 7,000 feet below the surface. Clyne commented that it was the deepest ever find in the Caspian and could, potentially, be a huge field. Although no technology exists currently that would allow for access to the field, Clyne said that the new find demonstrated that the Shah Deniz field was more complicated than originally thought and also potentially much more productive once technology to access it became available.

¶8. (C) Schrader believes that prospective European customers are concerned by the current lack of commercial access for ACG Deep Gas. Schrader said that there was enough gas in the southern Caspian Sea to fill Nabucco for years, but without a contract and confirmation that these reserves exist and gas will be produced, doubts will remain. Schrader said that one contract on ACG Deep Gas would go a long way toward convincing the Europeans that the gas will be there in a timely manner.

¶9. (C) A/S Sullivan also inquired about potential gas supply problems for Georgia this winter. Ruddiman commented that Georgia is currently in balance, but will need to continue imports of Russian gas, as well as imports from Azerbaijan, this winter. Ruddiman expressed frustration with the fact that Georgia continues to refuse to sign a long-term supply contract with another supplier. Ruddiman said that, last year, Georgia got lucky with the warm weather, but will continue to face crises of gas supply each year until it signs a long-term deal.

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¶10. (C) Turning to Turkmenistan, A/S Sullivan gave a readout of his meetings with the new President and asked the BP reps what their impressions were. Schrader said that BP's Andy Inglis was planning to go to Ashgabat during the week of August 20 to meet with Turkmen officials. Schrader said that he felt confident that the Turkmen would come to realize that Azerbaijan is a viable option for exporting their natural resources, as Chinese markets are far away and difficult to access, the GOTX doesn't want to keep losing money from its gas sales through Russia, and that the current political climate will prevent the GOTX from selling additional volumes to Iran.

MOF Sharifov

¶11. (C) In a wide-ranging meeting and lunch with Minister of Finance Sharifov that focused mainly on bilateral economic cooperation (septel), A/S Sullivan also discussed the status of transit negotiations with Turkey. Sharifov expressed frustration with the GOT, stating that the GOT needs to separate commercial and legal issues in the negotiating process, or an agreement will continue to be delayed. Sharifov criticized the Turkish Government's decision to nominate BOTAS, a commercial entity, as the main negotiator, arguing that the two countries needed to negotiate a legal document first before reaching a commercial agreement. Sharifov said that there are legal issues that BOTAS does not have the power to decide that need to be settled. Sharifov

said that the GOT is a signatory of the Energy Charter and the USG and GOAJ should hold them to those terms in any new transit agreement. Sharifov expressed frustration that a large number of technical issues continued to pose obstacles to a final agreement, including the cost of moving gas across the Turkish grid, the ratio of exchange of gas, and the calorific value of Turkish versus Azerbaijan gas. Sharifov made a strong pitch for USTDA-funded technical assistance to support legal and technical due diligence in connection with the transit talks.

FM Mammadyarov

¶12. (C) As a prelude to the signing ceremony of the USTDA grant, A/S Sullivan met with Foreign Minister Mammadyarov and discussed energy security issues and expressed support for the GOAJ's continued engagement with Turkmenistan. Mammadyarov said that Turkmen officials were much more confident in recent meetings than they had been during Mammadyarov's initial visit to Ashgabat, interpreting this as a positive sign that relations can move forward. Mammadyarov said that he also had good talks with Kazakh Government officials in a recent trip to Astana regarding Caspian delimitation. Mammadyarov said that, during his meetings with Kazakh officials, there had been discussion of a tri-partite meeting between Kazakhstan, Azerbaijan, and Turkmenistan that would result in, at least, a signed statement of intentions to develop a Trans-Caspian Pipeline. A/S Sullivan expressed interest in this idea and Mammadyarov said that USG support was welcome, but the Kazakhs had insisted that they talk to the Turkmen regarding the issue on their own.

¶13. (C) Overall, Mammadyarov stressed that he believes U.S. energy strategy should be more publicly visible, adding that the USTDA grant signing ceremony was a good example of the type of visibility that was needed. A/S Sullivan commented that these were good ideas, and also stressed the need for high-level European involvement that is so crucial to moving the project. Mammadyarov replied that energy strategy should be raised to the level of President of the European Commission Jose Manuel Barroso so that the entire EU can become involved in the process. Mammadyarov also stated that it would be good for the EU to become more involved in the Turkey transit process and commented that, during negotiations on the BTC, there wasn't a breakthrough until a third party became involved at the Istanbul Summit. Mammadyarov said that the transit talks with Turkey need that kind of engagement and said that the EU can play this role.

¶14. (C) A/S Sullivan also asked Mammadyarov about the current state of Caspian delimitation negotiations. Mammadyarov said that the last round of negotiations finished

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up in July and that the Turkmen appear to be getting more interested in resolving the issue and less hostile in negotiations. Mammadyarov said that the GOAJ again reiterated its position supporting a median-line approach, but the Turkmen did not respond.

¶15. (C) COMMENT: GOAJ interlocutors were enthusiastic and engaged with Sullivan, whose visit addressed their frequent requests for tighter coordination with the USG on energy, and especially, on Turkmenistan. We continue to hear from them that focused, consistent and high-level USG attention is key to advancing our Caspian energy, especially gas, objective. The signing of the USTDA Grant received wide and positive coverage in the local press, with A/S Sullivan emphasizing that this was an example of the next phase of Caspian development, and from the GOAJ more broadly, sending a clear signal of U.S. interest and support. The USG will want to follow up on Kazakhstan's initiative for a trilateral meeting or agreement with Turkmenistan and Azerbaijan, and work with Caspian partners to increase the visibility of the

EU in the region.
DERSE